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Pe & Investments

The Newspaper of Corporate and Institutional Investing

$9 An Issue $135 A Year

AT DEADLINE

4 from TPF&C form own firm

Four TPF&C employees in Chicago have left to form a benefits and consulting firm.

Thomas S. Terry, principal and vice president; Harold S. Cooper, principal; James G. Peard, principal; and Lina E. Flores, associate consultant, will open their own Chicago-based employee benefit and actuarial consulting firm in April, servicing mid- to large-size companies.

Steel union gets guarantees

The three-year contract with USX Corp. ratified last week by the United Steelworkers of America contains a host of pension gains for employees.

The contract guarantees pension benefits for five years in the event USX spins off any of its steel division and a plant subsequently shuts down. USX also has agreed the assets of the whole corporation stand behind pension and retiree health obligations.

Kilcullen named to post

Daniel M. Kilcullen has been named executive vice president of the Boston Co. and its chief subsidiary, the Boston Safe Deposit and Trust Co.

He will manage the firm's securities management group, which administers more than $230 billion in assets, and succeeds Robert E. Mainer who had headed the unit on an interim basis.

He most recently was manager of the master trust division.

Fund boosts account

The $30 billion California State Teachers Retirement System gave an additional $25 million for equity management to W.R. Lazard & Co. The commitment, to be funded April 1, brings the total amount managed by the firm for the pension system to $57 million.

INSIDE

AP/Wide World Photos

Searching for capital

Direct oil and gas investments remain on the back burners at many corporate pension funds, but dealmakers are hoping interest in energy will begin to heat up among public retirement systems. Page 3.

Photo by Mary Herlehy

Shareholders of Waste Management will get a chance to vote on independent board directorships because of the SEC ruling.

Board independence on 2 proxy ballots

By Joel Chernoff

WASHINGTON — The Securities and Exchange Commission has ruled proxy resolutions asking that a majority of the board of directors be independent may be placed on proxy ballots at Waste Management Inc. and Dow Chemical Co.

The actions by the SEC's corporate finance division open the door to shareholder challenges of ingrown boards of directors. The rulings also grant institutional investors access to the broadest corridors of power within corporations, and threaten to disrupt traditional relationships between management and directors.

The SEC's letters also are a triumph for the Council of Institutional Investors, which has encouraged its member pension funds to challenge inbred boards. The council represents more than 60 pension funds with more than $300 billion in assets.

Both the $21 billion Florida State Board of Administration, Tallahassee, which authored the Dow Chemical proposal, and the $1 billion-plus Carpenters, District Council, Southern California pension fund, Los Angeles, which initiated the Waste Management resolution, are members of the council.

See **Boards** *on page 31*

404(c) proposal hits employers' wallets

By Hillary Durgin

WASHINGTON — The Department of Labor's revamped proposed regulations affecting participant-directed retirement accounts could increase employers' costs.

The long-awaited 404(c) rules — the Labor Department's most important regulatory project affecting the investment of defined contribution assets — affect the nation's $282 billion in 401(k) salary reduction plan assets.

The proposal is intended to provide employers with limited relief from fiduciary responsibility for the investment decisions participants make.

To avoid that liability, employers would have to follow three broad principles:

- Employers would have to provide a "broad range of investment alternatives" — including at least three diversified investment categories with different risk and return characteristics.
- Participants must be able to switch their investments no less frequently than once every three months.
- Participants must have the opportunity to diversify investments generally and within investment categories.

The proposal comes as corporate executives register increasing concern over the safety of their investments, particularly those invested with the insurance industry, consultants said.

"Plan sponsors want the relief," said Tim Hankins, consultant with The Wyatt Co., Sherman Oaks, Calif. "A lot of plan sponsors are concerned that they are liable as an organization or as an individual as to how well these funds perform."

Overall, pension consultants,

See **Proposal** *on page 33*

Bankruptcy panel blazing new trail

Retirees have voice in benefit talks

By Hillary Durgin

CINCINNATI — Allied and Federated department stores are attempting to cut retiree benefit costs by an estimated $50 million during the next 10 years using ground-breaking procedures in bankruptcy court.

In a closely watched case that is expected to set precedents for benefits negotiation in bankruptcy proceedings, Federated Department Stores Inc. and Allied Stores Corp. are negotiating with a special 15-member committee of non-union retirees to reduce medical and dental benefits.

Companies that file for protection from creditors under Chapter 11 must negotiate with a committee representing their retirees if they want to modify benefits. Allied and Federated, Cincinnati-based subsidiaries of Federated Stores Inc., filed Chapter 11 petitions Jan. 15, 1990. The companies plan to file their plans for reorganization by April 29.

The appointment of the retiree committee was made under a relatively new and little-used provision of the Federal Bankruptcy Code, Section 1114, which protects retirees in Chapter 11 bankruptcy situations. Michael Macris, a partner at Cahill Gordon & Reindel, the New York law firm that is representing the retiree committee, said the proceedings will set precedents about determining how a case involving Section 1114 works.

"You're trail-blazing," Mr. Macris said.

"If any debtor in bankruptcy is seeking to reduce payments of retiree benefits, the debtor is going to have to go through this process," said Bill Gannett, associate with Cahill Gordon.

The special retiree committee was appointed Oct. 4 by an order of the U.S. Bankruptcy Court,

See **Allied** *on page 35*

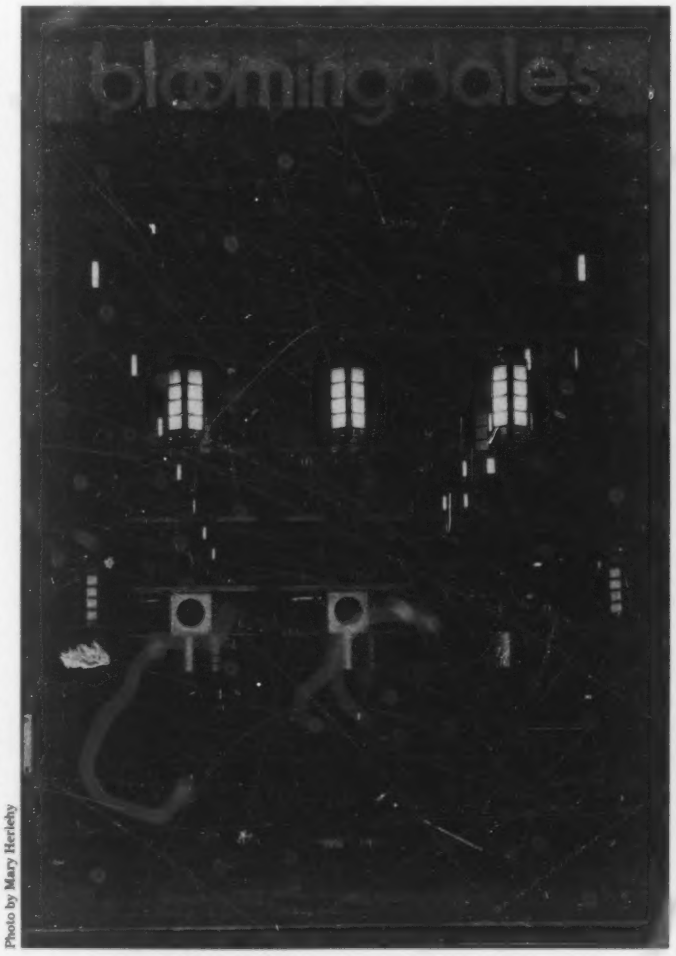

Photo by Mary Herlehy

Retirees from Bloomingdale's will be one group represented on a bankruptcy panel negotiating a plan for cutting retiree benefits.

NEWS DIGEST

AP/Wide World Photos

Dresden and other Eastern European cities are being targeted for real estate investment through a new fund aimed at institutional investors. Story on Page 18.

SPECIAL REPORT: GICs

As growth of the guaranteed investment market appears to be tapering off, pension plan sponsors are exploring ways to diversify risk through the use of alternative contracts. Page 19.

FINANCING

Allied and Federated department stores are attempting to cut retiree benefit costs using ground-breaking procedures in bankruptcy court. Page 1.

The private placement market shrank for the first time in a decade, stricken by a drop in ESOP financings and highly leveraged transactions. Page 34.

INTERNATIONAL

Two U.K. pension funds are joining a few others in offering their in-house investment expertise to outside clients. Page 2.

Interest in global tactical asset allocation is building among pension fund executives. Page 3.

Union Bank of Switzerland is one step closer to its goal of becoming a leading global asset manager with the acquisition of Chase Investors Management Corp. Page 25.

REAL ESTATE

The Teachers Insurance and Annuity Association — College Retirement Equities Fund is planning to commit up to $3 billion to permanent financing in 1991. Page 3.

With returns at a record low in 1990, poor-performing real estate investment managers soon could find their heads on the chopping block. Page 6.

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NCR wooing institutions

Executives take to the road to counter AT&T offer

By Curtis Vosti

DAYTON, Ohio — NCR Corp. officials are flying around the country wooing institutional investors as they brace for battle March 28 against American Telephone & Telegraph Co.

Meanwhile, the two sides were in U.S. District Court in Dayton March 11 and 12, arguing over the legality of the $500 million employee stock ownership plan NCR instituted Feb. 21. A decision is expected by March 19, nine days before special and annual meetings of NCR shareholders.

Each side has played other cards and is expected to reveal others as the March 28 vote nears.

Charles Exley Jr., chairman and chief executive officer of NCR, personally has been visiting some of the larger institutional shareholders in the last weeks prior to the vote.

While the pressing-of-the-flesh seems more akin to a political fight than a proxy vote, it perhaps best illustrates the growing power of institutions in corporate governance issues, observers say.

But NCR spokesman Robert Farkas said the late-date fly-around was part of a continuing strategy. "It's been something he's been pressing ever since the offer was made in December," he said.

While the moves and countermoves continue, institutional investors have been discussing the merits of AT&T's takeover proposal. Many say they expect the telecommunications giant to prevail.

The Council of Institutional Investors has invited both sides to meet March 21 in Washington to discuss the issues with members.

Meanwhile, a March 1 analysis of a $90-a-share offer from AT&T by Eric Ovsiew and Wayne Marr, deputy counsel general and chief economist, respectively, at Institutional Shareholder Services Inc., Washington, recommends that shareholders who own at least five times the market capitalization of AT&T stocks as the capitalization of their holdings in NCR reject the merger proposal, while those with less than five times accept the merger. ■

U.K. funds to market their skills

By Margaret Price

LONDON — Two more U.K. pension funds are opening their in-house investment expertise to other pension funds.

Imperial Chemical Industries PLC and the Electricity Supply Pension Scheme are joining a handful of others, including the investment arm of British Coal Pension Funds, that offer asset management to outside clients.

ICI Investment Management Ltd., London, which manages investments of Imperial Chemical Industries' $8.5 billion pension fund, mainly wants to attract larger funds, those with assets of at least 100 million pounds, said Graham Allen, investment director.

ICI Investment Management already manages assets of a U.K. charity, which Mr. Allen declined to identify.

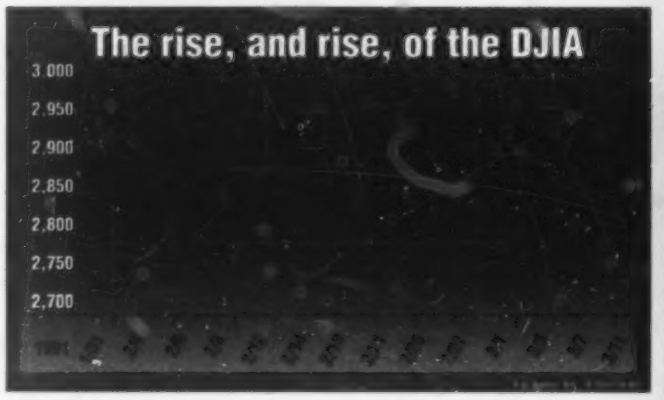
The $16.1 billion Electricity Supply Pension Scheme, which plans to start its outside management activities this year, is targeting small to midsize pension funds. Fund executives still are awaiting approval to offer external management from the Investment Management Regulatory Organization and the electric companies whose assets it now manages. The new unit most likely will operate under the name of E.S.N. Investment Management Ltd.

ICI and Electricity Supply both would offer balanced investment management — including real estate — to outside clients.

ICI decided to extend its managerial services primarily to improve the information flow it receives from brokerage houses. The intentionally low turnover (less than 20%) of the fund's securities holds brokerage commissions in check, which means the brokerage community hasn't always been forthcoming with ideas. ICI fund executives reason the larger the asset base, the more frequent the securities transactions and, therefore, the more frequent the information from brokerage firms.

ICI executives also see an opportunity for corporate cost savings by expanding management services. As Mr. Allen explained, added profits

See **Skills** *on page 34*



Gurus more bullish than large investors

By Margaret Price

As the Dow Jones Industrial Average again approached 3,000, Wall Street strategists were singing in unison glad tidings of the new bull market — but institutional investors didn't automatically join the chorus.

While some investors shared the view that the stock market was heading higher and the recession would ebb, others fretted over unfavorable signs, ranging from what they considered to be unattractive stock valuations to worries about a lingering recession. In fact, some said the market's very euphoria in recent weeks was reason for caution.

Wall Street analysts have produced generally cheery outlooks and a litany of reasons to be bullish. Among the causes for the rosy outlooks are expectations for lower interest rates, more moderate inflation, stronger corporate profits in the second half and the return of individual and foreign investors to the market.

While not offering a prediction for the DJIA, Steven Einhorn, portfolio strategist at Goldman Sachs & Co., New York, said: "Stocks will do appreciably better than cash and do better than bonds" in the coming six- and 12-month periods.

David Bostian, chief economist and investment strategist at Jesup, Josephthal & Co. Inc., New York, foresees the Dow at 5,000 by 1995. His rationale, in part: the market value of the New York Stock Exchange, at $2.6 trillion, was slightly below 50% of the gross national product last November, but will have risen to 70% of an expected $7.5 trillion in GNP by 1995. That doubling of the NYSE's market value implies a doubling of the Dow, he said.

Mr. Bostian recommends an asset mix of 50% equities, 10% gold or gold stocks and 40% Treasury bonds, but he soon might trim bond exposure to 30% and invest that money in cyclical stocks.

A. Marshall Acuff Jr., portfolio strategist at Smith Barney, Harris Upham & Co. Inc., New York, and a professed "early bull" (beginning at year end) said he is "still positive, although the market has come a long way." He sees the Dow trading between 2,400 and 3,100 this year.

An even earlier bull, Michael Sherman, investment strategist at Shearson Lehman Brothers Inc., New York, said he increased his recommended stock allocation to 65% from 55% last March. (His remaining allocation is 30% long-term Treasuries and 5% cash.)

Many institutional investors, however, are being cautious, noted William H. Donaldson, chairman of the New York Stock Exchange at a New York Financial Writers' Association luncheon last week. Mr. Donaldson said it might be "better to buy when everyone's not on the bandwagon. . . . I think at any point in time there are good investments out there. But the market has had a good rise," he said, acknowledging the Dow's trouble piercing the

See **Investors** *on page 34*

INVESTING

NYSE exec pans short-term goals . . .

■ William H. Donaldson, the new chairman of the New York Stock Exchange, is criticizing pension funds for using passive investment strategies that try to match the market's performance instead of trying to beat it.

Speaking at the National Press Club, Mr. Donaldson said money managers, under pressure from plan executives to produce short-term gains, are turning to complex techniques to stay even or slightly outperform the market while ignoring traditional stock-picking techniques.

That "can lead us toward less diversity in the market," he said. He also warned against treating individual equities like commodities — "trading them en masse like soybeans or pork bellies."

Passive investing eviscerates the stock market's main asset-allocation function, he added. What's more, short-term strategies are leading institutional investors to use alternative trading mechanisms that would fragment the market and could reduce liquidity and hurt price discovery, he warned.

William Donaldson is critical of passive investment strategies.

. . . but study reveals pension funds' long-term nature

■ Pension funds might be longer-term investors than some market experts suspect.

A pilot study by Carolyn Brancato, chief economist for Columbia University's Institutional Investor Project, shows two multibillion-dollar pension funds had surprisingly high levels of continuous ownership of their stocks between 1984 and 1989.

One fund, which had both internally managed indexed assets and actively managed stocks run by outside managers, still held at the end of the five-year period 44.3% of stocks that were owned before or purchased during the period; 12.2% of the fund's stocks were held for more than five years.

The second fund, whose stocks were managed entirely in-house on an active basis, held 61.3% of the shares owned before or purchased during the period; 19.2% of the fund's stocks were owned for more than five years.

Ms. Brancato, who also is director of the Riverside Economic Research Institute, hopes to expand the study to 20 public and private pension funds.

The gender gap: Women still trail men in average salary

	Undergraduate			MBA		
	Men ($ thousands)	Women	Salary ratio Men/women	Men ($ thousands)	Women	Salary ratio Men/women
Corporate titles						
Analyst	37.80	35.93	105.2%	42.65	41.41	102.9%
Manager	54.33	44.52	122.0	58.87	54.27	108.4
Cash manager	44.58	39.86	111.8	53.12	45.66	116.3
Director	65.54	45.50	144.0	70.33	65.00	108.2
Assistant treasurer	67.26	53.28	126.2	65.83	58.41	112.7
Treasurer	64.81	61.00	106.2	73.52	71.43	102.9
Vice president	72.83	70.00	104.0	75.16	62.50	120.3
All corporate titles	57.46	42.67	134.7	62.57	53.39	117.2
Bank titles						
Assistant vice president	37.69	40.52	93.0%	41.14	45.00	91.4%
Vice president*	59.79	51.95	115.1	67.79	62.74	108.1
Senior vice president	80.05	69.60	115.0	85.31	107.00	79.7
All bank titles	55.62	45.21	123.0	64.89	57.74	112.4

*Includes the title vice president and treasurer

Source: National Corporate Cash Management Association, Bethesda, Md.

Graphic by Holly Seguine

CASH MANAGEMENT

Women have come far, but there's still a ways to go

■ Women continue to be paid less than men in the treasury management profession, in both corporations and banks, a survey shows.

The average salary for all corporate treasury management titles was $54,000, but the average male's salary was $59,800 vs. $46,100 for the average female, according to the third annual compensation survey, conducted by the National Corporate Cash Management Association and the Journal of Cash Management.

Higher education played an important role in compensation, the survey showed.

After adjusting for gender, age, experience and other factors, an MBA was worth more than $5,300.

The highest overall salaries were reported by treasury professionals in the energy, manufacturing and communications industries. The highest salary increases were reported in the service, insurance and other financial service and retail industries.

Of the respondents, 2,221 were from corporations and 699 from banks.

COMMERCIAL PAPER

Europe's markets smaller, riskier

■ More than half of the commercial paper defaults of the past two years occurred in the developing European commercial paper markets.

Those markets accounted for 57% of the defaults, while the remaining 43% occurred in the much larger U.S. commercial paper market.

According to a special report published by Moody's Investors Service Inc., New York, the defaults in the European markets totaled $533 million, or $3.64 for every $10,000 of commercial paper issued.

In comparison, defaults for U.S. commercial paper totaled $1.1 billion, or 37 cents of every $10,000 invested.

INTERNATIONAL

It's 'Erin go braugh' for investors

■ Investors in country funds should count on the luck of the Irish, a research report by PaineWebber Inc. shows.

Many country funds — which are publicly traded, pooled vehicles for investment in foreign markets — are trading at discounts to net asset value, although these discounts have narrowed somewhat since the end of last year, said William Dinning, a PaineWebber vice president. The average discount was 9.9% at year end; it was 1.1% early in March.

The Irish Investment Fund was trading at an 18% discount early this month, making it the best value of any country fund, Mr. Dinning said. The fund was at 87% Irish equities, its highest market exposure ever, with the balance in short-term instruments. With 40% of its exports going to the United States and United Kingdom, Ireland stands to benefit when these economies come out of recession, likely later this year, Mr. Dinning said.

He also noted the Emerging Mexico Fund, trading at an 11% discount, stands to benefit from economic reforms in Mexico and the move toward a free trade agreement with the U.S. Another good value, he said, is the Latin America Investment Fund, at a 13% discount; this fund invests in Mexico and other Latin American countries.

Other funds offering good long-term appreciation potential are the Growth Fund of Spain, New Germany Fund, Future Germany Fund, France Growth Fund and Europe Fund, Mr. Dinning added.

PEOPLE

He doesn't make house calls either

■ True story:

While on an airplane flight, Merton H. Miller, Nobel laureate and University of Chicago professor of economics, was paged as "Dr. Miller." A woman in the next seat asked about his specialty.

"Econometrics," he answered.

"Oh," she replied. "There's a lot of that going around these days."

— *Crain News Service*

ASSOCIATIONS

AIMR to include Japanese analysts

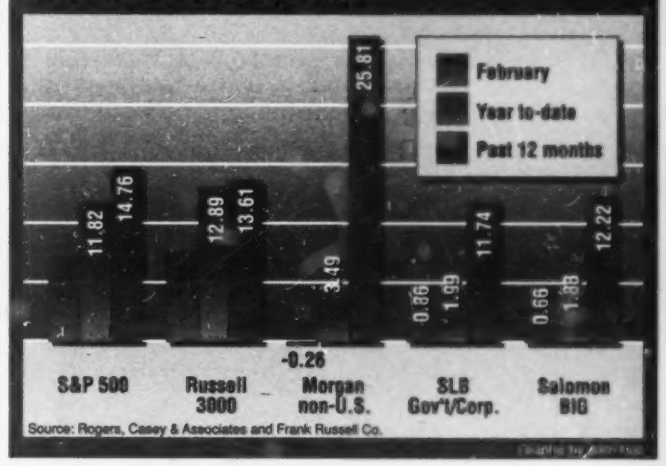
■ Japanese investment professionals will be able to become chartered financial analysts under an agreement reached between the Association for Investment Management and Research and the Security Analyst Association of Japan.

AIMR, which sponsors the CFA designation, hopes to extend investment analyst standards overseas with the new agreement. A similar agreement was reached between the organization and the Society of Investment Analysts in London in 1989.

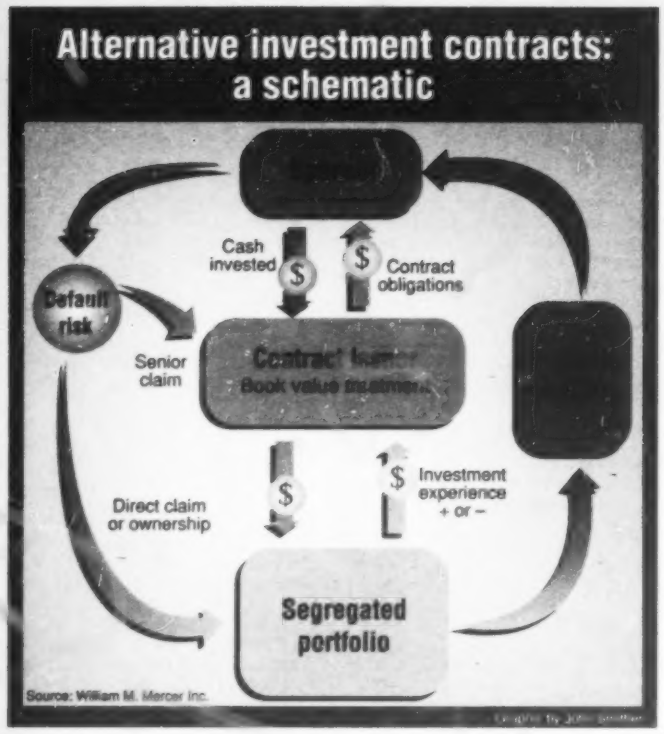
AIMR's Japanese counterpart has 2,400 "chartered members of the association." The new agreement will permit the CMAs to take special exams to qualify for the CFA; a reciprocity feature will allow U.S. investment professionals to become CMAs.

Pensions & Investments' indexes

The P&I monthly indexes track changes in the Standard & Poor's 500, Frank Russell Co.'s Russell 3000 Stock Index, the J.P. Morgan non-U.S. Government Bond Index, the Shearson Lehman Brothers Government/Corporate Bond Index and the Salomon Brothers Broad Investment Grade Bond Index.



Source: Rogers, Casey & Associates and Frank Russell Co.



Alternatives offer ways to spread risk

By Curtis Vosti

Plan sponsors seeking to diversify from the risk associated with investment contracts have pumped nearly $10 billion into alternatives in the past year.

These alternatives, offered by banks and insurance companies, offer sponsors a way to offset the contracts' industry concentration through diversification of the underlying assets.

In some cases, alternatives can be used to enhance yields, creditworthiness and/or liquidity while still maintaining the advantages of the guaranteed contracts: book value accounting, dedicated rates of return and stipulated maturities.

"You can design an alternative that looks, smells and feel very much like a GIC," said Gordon Maltempo, vice president for marketing guaranteed products at Aetna Capital Management Inc., the investment management subsidiary of Aetna Life Insurance Co., New York.

Mr. Maltempo said the typical GIC alternative allows the plan sponsor to insulate plan assets from the general account insurance company risk by separating those assets and/or specifying the underlying securities that back up the guarantee.

The sponsor can end up with an actively managed portfolio with a book-value overlay and can diversify its assets from insurance industry concentration while keeping the liquidity associated with guaranteed and bank investment contracts.

Depending on the product, the bank or insurance company also can provide back-up guarantees for the underlying assets.

Such diversification led E.I. du Pont de Nemours Inc., Wilmington, Del., to invest $300 million in two separate account GICs in the last year, according to Bill Smith, vice president for liability management.

The company's three savings plan have about $5 billion invested in GICs. Mr. Smith said the company chose to use mortgage-backed securities as the underlying asset for its alternatives because of higher spreads over Treasuries and excellent market value, he said. "And if there's a yield kicker to that, we're happy to take it," Mr. Smith said.

Choosing alternatives also involves a tradeoff, he said, from the chance of pre-payment of the mortgage securities to the risk of industry concentration. But he isn't concerned.

"We've not seen any of the risks materialize, and there are ways we can mitigate that," he said.

"Normally, the plan sponsor is trading one risk for another" by using alternatives, said Sharon Morell, vice president of Morley Capital Management Inc., Lake Oswego, Ore.

With GIC alternatives, the buyer can be the owner of the underlying securities so the risk is no longer in the choice of the insurance carrier, but in the choice of the underlying assets. (Those can be chosen either by the issuer or the plan sponsor, and can include government agency bonds, high-grade corporate bonds or even asset-backed securities like credit card receivables.) While the separate account GICs can offer a higher yield because the insurance company needs less reserves, the rate could in future years fluctuate to reflect the market experience of the underlying securities.

Pacific Investment Management Co., Newport Beach, Calif., offers alternatives using mortgage-backed securities with an average five-year maturity, steady payment stream and pass-through experience. The Putnam Cos. Inc., Boston, offers The Guaranteed Horizon Trust, using government or agency bonds and adds two other tiers of backup, which it says guarantees an annual rate to maturity and book value accounting. Other issuers include CIGNA Asset Advisors Inc., The Travelers Cos., Prudential Insurance Co. of America, Metropolitan Life Insurance Co. and Citibank Investment Management.

See **Risk** *on page 21*

The market's thrill is gone

Lack of new 401(k) plans slows growth to single digits

By Fred Williams

The growth of the guaranteed investment market appears to be slowing as the market approaches adolescence.

The strong demand for guaranteed and bank investment contracts in the past five years took place in spite of highly visible problems of enormous junk-bond holdings, problem real estate and mortgage loan portfolios of insurance companies, the major players in the GIC/BIC market.

Now, industry sources across the board believe the rate of growth that has been nearly 20% per year for the past two or three years is slowing; some believe it will be in single digits this year or next.

In a bit of irony, any actual change in the market probably will not be due to the well-documented problems of insurers and banks, but could stem from the very success GICs and BICs have experienced with 401(k) plan participants.

The explosion in the guaranteed marketplace to a $200 billion industry, about 5% of which is made up of BICs, has resulted in increased attention from regulators. The most notable and potentially most significant is the Financial Accounting Standards Board review of one of the most popular features of guaranteed investment products — book-value accounting. Book-value accounting allows plan sponsors to carry guaranteed products at a constant value without market volatility.

Brian Ternoey, principal at A. Foster Higgins & Co., Princeton, N.J., said demand for GICs grew 18% in 1990, down from 25% in 1989.

"The rate of growth is leveling off. It will continue to grow, but (the market) is certainly maturing. . . . I expect growth to continue in 1991 but I expect it to come down a lot, maybe in the single digits," said Mr. Ternoey.

The slowdown, he said, largely is due to the economic downturn "because a lot of people are losing their jobs, contributions are not going in and re-investment may be down." He said much of the continuing demand for guaranteed products is coming from maturing contracts that are being rolled over into new ones.

Mr. Ternoey, and virtually everyone familiar with the guaranteed market, believes the demand for GICs and BICs will continue to come from the 401(k) market, but Mr. Ternoey said that adding new plans and participants "probably doesn't represent more than 5% of the market now."

Surveys by Foster Higgins and other investment consultants continue to show GICs as the single most popular option in participant-directed 401(k) plans, which usually have at least 60% of assets going into GICs.

"As the 401(k) market goes, so goes the GIC business," said Jason Psome, partner with the GIC consulting firm of Brentwood Asset Advisors, Santa Monica, Calif.

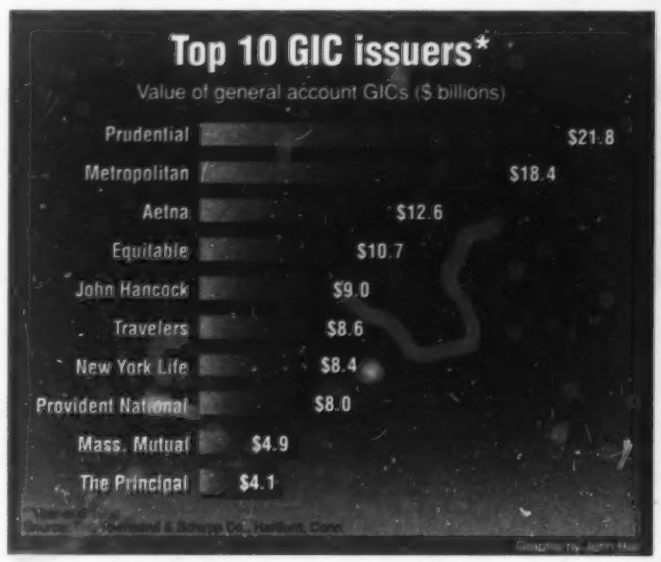
"In the past five years, the huge growth in 401(k) plans has fueled the GIC market but that kind of growth is finite in and of itself. Eventually you will get to the saturation point. Most of the new business we do is not from new plans, but from plan sponsors already in the GIC market who don't want to do it themselves anymore."

Plan sponsors remain positive on the outlook for guaranteed investments, if not as enthusiastic as the plan participants who see the contracts as safe, secure and not subject to market fluctuations as are equities and other fixed-income investments.

GICs and BICs will continue to make up the bulk of 401(k) investments, according to plan sponsors.

"It is employee money and employees have voted enthusiastically for that type of investment," said John Bell, assistant treasurer at Consolidated Edison Co., New York. Guaranteed investments "are widely accepted and liked by participants. They like it so much it's overdone, in some cases." He said some younger employees have elected to invest "almost entirely" in GICs to the exclusion of the equity market "when capital market theory would require the laws of gravity be suspended

See **Growth** *on page 22*



Problems mar industry image

By Fred Williams

Mounting losses from junk bonds and real estate have tainted the health of the insurance industry — central to the continued development of the guaranteed investment market -- although the likelihood of default remains remote.

But the woes faced by insurance companies with problem real estate, junk bonds and capital adequacy have caused some to draw parallels with the troubled thrift business, warranted or not.

Insurance industry troubles also have called into question the role of credit-rating agencies and whether they are fulfilling their role in a timely fashion.

"It is a strong industry with a couple of problems," said David Schupp, partner with Townsend & Schupp Co., an insurance rating service in Hartford, Conn. "Some companies have had aggressive postures with junk bonds and aggressive postures focusing on mortgage investments in what turned out to be volatile areas of the country, (so) they've had problems of concentration."

Thin profit margins on GICs, with spreads ranging from 25 to 75 basis points, "will continue to result in GIC issuers investing in junk bonds, commercial real estate and private placements in order to maintain margins," according to a recent commentary from T. Rowe Price Guaranteed Asset Advisors, Glen Allen, Va.

According to Moody's Investors Service 1990 Life Insurance Industry Outlook, insurance company asset quality is "marginal" and "GIC writers have been accepting (sometimes unknowingly) higher credit risk in investments in order to maintain the spreads in this sector."

Most problems associated with junk bonds have centered around the highly publicized problems of Executive Life Insurance Co., Los Angeles, which wrote off $800 million in junk bond losses last year. Executive Life has about $3 billion in GIC liabilities outstanding.

But expanding problems in the real estate market have captured the most attention recently. Several large carriers face difficulties in their real estate and commercial mortgage portfolios. Travelers Insurance Co. held a total of $993 million in foreclosed real estate properties at the end of September 1990, according to Townsend & Schupp.

Other companies with large amounts of foreclosed properties include Aetna Life Insurance Co., $679 million; Equitable Life Assurance Society of the United States, $434 million; New York Life Insurance Co., $432 million and Mutual Benefit Life Insurance Co., $348 million.

In addition, there are billions of dollars of non-performing mortgage assets in insurer portfolios. According to Salomon Brothers

See **Image** *on page 20*

Growth

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to believe equities couldn't outperform over the long term."

Con Ed has about $350 million of its $400 million 401(k) plan in GICs and concerns about credit quality of the insurance business, while warranted, may be overdone, said Mr. Bell.

"There are still several AAA rated companies and 401(k) plans typically invest in GICs in the four- to five-year maturity range. It takes a leap of faith to believe a AAA company can get into a situation where it couldn't keep up with claims against them," he said.

William E. Rose, director-risk insurance and retirement assets at TRINOVA Corp., Maumee, Ohio, which has $309 million of its $350 million 401(k) plan in guaranteed assets, said for employees "GICs still carry tremendous weight with a given return, even though you can tell them about capital market theories regarding long-term returns available in the equity market.

"But, we also tell them to choose an option they will be comfortable with. With GICs there is the perceived security, even though I am not certain it is more secure than any other alternative."

He said TRINOVA limits its placements to top-quality AAA rated carriers and uses its consulting firm, Becker & Rooney Inc., Teaneck, N.J. to assist in credit analysis and placements.

Mr. Rose, too, said criticism of the insurance industry solvency, credit quality and investments has been overdone. "I believe they will remain popular as long as the government doesn't do something strange with the accounting rules."

Yet, changes in the accounting rules are in the offing.

In a stunning development last year, the FASB announced it would address the book-value accounting of GICs and BICs with the goal of clarifying the accounting method used for the contracts, possibly requiring some form of market-value accounting (*Pensions & Investments*, May 28).

The announcement sent shock waves through the industry that still are reverberating. Marking GICs and BICs to market would change the nature of the vehicle and, according to industry sources, remove one of the principal advantages of buying the contracts.

Don Delaney, project manager for the GIC analysis at the FASB, said the review is on course and the board still is gathering information. He said an exposure draft is expected to be issued during the second quarter, with a final standard expected by the end of the year.

Mr. Delaney said market value is still the crux of the board's deliberations, and he is aware of the industry's concerns about the impact of requiring market-value accounting for GICs.

"I hear what they are saying, but we are trying to come up with the proper accounting method for these vehicles."

Larry Mylnechuk, executive director of the GIC Association, an industry trade association, said he expects the FASB to allow some flexibility when the final standard is issued and believes there will be exemptions in some cases, possibly allowing a continuation of book-value accounting for some benefit-responsive GICs.

Whether FASB requires some form of market-value accounting for GICs and BICs, there is a sense the insurance and banking industries already are responding by developing alternatives, or synthetic GICs. Synthetic GICs usually are asset-backed, floating-rate instruments with the same characteristics as GICs but are marked to market. ■

Most new GIC/BIC business (net)*

Banks & insurance companies

Firm	$ millions
Hartford Life	1,390
CNA Insurance	1,132
Provident Nat'l Assurance	1,100
Allstate Life Insurance	714
John Hancock	597
New York Life	509
Crown Life Insurance	462
State Street Bank	336
Great-West Life	145

GIC portfolio managers

Firm	$ millions
Bankers Trust	1,722
Fidelity Investments	1,323
PRIMCO Capital Mgmt.	850
Certus Financial	700
Morley Capital Mgmt.	456
IDS Trust	332
Fiduciary Capital Mgmt.	158
Vanguard Group**	107
ASB Capital Mgmt.	35

*U.S. institutional tax-exempt assets in 1990
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Image

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plan sponsors "should not accept" any public evaluation of these companies but should conduct their own evaluation or get some independent help in making these assessments."

He noted Executive Life held an investment grade rating until the day the bottom fell out of its junk bond portfolio.

Rating agencies "are all reactionary," said Mr. Schmidt, noting that rating changes "all seem to come after the fact, after the bad news, which means they aren't anticipating where the credit is going."

Mr. Meigs defended the rating agencies' role. "We don't have a crystal ball; when you look at the rating agencies you have to ask: Are they bringing any useful information to the table, highlighting the issues and difficulties that the consumer of ratings should take into account in his decision making? The answer is that they are."

Mr. Schupp said his firm "has been very conservative in the way we apply a rating."

"We feel our clients want us to give them a rating on a company that allows them to make a decision that has some stamina. If you get an AA rating today, they should not expect that rating to change dramatically in the near future," he said. ■

Pensions & Investments welcomes letters to the editor. Letters should include the name, address and company of the writer.

The editors reserve the right to edit letters.

Private placements dive

Volume plummets following ESOP financings retreat

By Lori Miller
and Marlene Givant Star

NEW YORK — Stricken by a 72% drop in ESOP financings and the evaporation of financing for highly leveraged transactions, the private placement market shrank last year for the first time in a decade.

Volume plunged 27% or $44.4 billion in 1990 to $120.6 billion from $165 billion the previous year, according to IDD Information Services Inc., New York. Private placements represented 28% of all stock and bond financings in 1990, compared with 35% in 1989.

One thing that didn't change was Goldman, Sachs & Co.'s No. 1 position in the market for the third consecutive year, with $16.1 billion in placements.

Goldman also captured the lion's share, 30.7%, of the 144A market.

Of the $44.4 billion decline in volume, $12.7 billion stemmed from the loss of preferential tax treatment for employee stock ownership plans.

"In 1989 we did quite a large amount of ESOP financing at Prudential. I would say that of our decline of 25%, about half was a decline in ESOP financing. It was a big part of the marketplace in 1989," said Mendel Melzer, senior vice president of Prudential Capital Corp., Newark, N.J.

"ESOPs had a huge impact on the private placement market. They over-inflated 1989 numbers," said Maleyne Syracuse, vice president for private placements at Bankers Trust Co., New York.

In addition, the disappearance of Drexel Burnham Lambert Inc. and the junk-bond market eliminated a key source of debt capital for private companies.

Activity also was strained by the bank credit crunch coupled with stepped-up scrutiny of insurance company investments by the National Association of Insurance Commissioners.

The passage last year of the Securities and Exchange Commission's rule 144A, which brought 37 issues to the market totaling $3.7 billion, was not enough to prop up volume, although bankers predict it could become a greater source of activity over time.

Rule 144A allows U.S. and foreign companies to issue — without registering with the SEC — stocks and bonds directly to big institutions that may trade the securities.

Second to Goldman in volume was First Boston Corp., which retained its 1989 rank with $10.6 billion in volume. J.P. Morgan & Co. moved up two notches to third place with $10.3 billion.

Commercial banks made strong showings for the second straight year, accounting for nine of the top 20 positions, with $38.5 billion in placements.

While IDD predicts the market will be flat in 1991, Mr. Melzer said so far this year Prudential Capital is experiencing an uptick from its year-earlier private placement volume, even without ESOP-related financings.

The enormous growth in private issuance from 1985 to 1989 was driven by many factors, from highly leveraged transactions and leveraged buy-out financings to ESOP loans to high quality companies.

"After extraordinary growth in issuance from 1985 to 1990, this represented a return to more normal debt issuance levels," Mr. Melzer said.

Growth so far in 1991 — largely in straight debt financings — has been spurred by the drop in interest rates, he said.

The only sector of the market that didn't decline last year was securitized placements, which increased to $19.6 billion from $19.4 billion.

"We do see private securitized transactions continuing to be a significant factor in the private market but we don't expect double digit growth rates in any particular area of private issuance," Mr. Melzer added. ■

1990 private placement rankings

Manager*	Amount $ millions	% of total	Number of issues
First Boston	10,644.8	8.8	119
Salomon Brothers	9,765.9	8.1	154
Lehman Brothers	7,087.7	5.9	84
Chemical Bank	4,575.9	3.8	99
Chase Manhattan	4,265.3	3.5	97
Kidder, Peabody	3,446.0	2.9	62
Continental Bank	3,351.8	2.8	65
Bank of America	2,280.5	1.9	51
Dillon, Read	1,424.7	1.2	32
Donaldson, Lufkin & Jenrette	1,275.3	1.1	29

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Investors

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3,000 level.

The New Jersey Division of Investment, Trenton, which manages $32 billion internally, including $27 billion in state pension assets, "is not jumping on any bandwagon," said Anthony Arcuni, the division's deputy director. "Our views on the equity market at this time are reasonably positive, (but) we would not be surprised to have a market correction, which we would see as a buying opportunity."

Mr. Arcuni expects a slow to moderate economic recovery during the next 12 to 18 months. At present, nearly 50% of the state's pension assets, or about $13 billion, is invested in equities, with the remainder in fixed income. Without being specific, Mr. Arcuni said the division's equity performance last year and so far this year has surpassed the Standard & Poor's 500 Stock Index.

The $9.3 billion Tennessee Consolidated Retirement System, Nashville, is "pushing up against its limitation on equities," said Charles Webb, chief investment officer; the fund has an equity range of 30% to 35%. Other allocations include about 50% in domestic bonds, 4.5% in foreign stocks, about 4% in foreign bonds with the rest in cash.

While the internally managed fund is not a market timer, officials found "over the past three to four months, more and more stocks looked very attractive, and we did increase our weighting somewhat."

The fund sees a number of attractive stock investments but could only buy them now by selling others in order to stay within its investment range.

That band could change in the near future. "We'll discuss (an unusual) change in that allocation in an advisory council meeting in a couple of weeks," Mr. Webb said.

Despite intraday highs, the DJIA — as of press time — has never closed above 3,000. This year's high and low marks were 2,973.27 March 6 and 2,470.30 Jan. 9.

The 30-stock index now stands significantly above its level of last fall, when the market dived on oil price and war concerns.

But breaching 3,000 may prove daunting for a while, said Ray Dalio, president of Bridgewater Associates, Wilton, Conn., who describes himself as a contrarian. Bridgewater has about $550 million under management.

He recalled the 1,000 mark for the DJIA was an impediment for the years between 1964 and 1983, while the 100 level proved formidable for about 20 years until the mid-1920s.

Among other factors, "the chorus of optimism" on Wall Street is also "something to be concerned about." Such euphoria shows "there is not an understanding or appreciation for why this cycle is different from past cycles."

A key difference between this and the last recession, he said, is that although the Federal Reserve has again eased monetary conditions, economic production during this recession — including an 80% level in capacity utilization — is far higher than during the recession of the early 1980s. That means "there's not much economic slack to accommodate growth, and we're also operating in an extremely leveraged economic environment," he said.

PDI Strategies, Newark, N.J., which manages about $10 billion, "started the year bullish with an overweighted position in stocks," said Mark Stumpp, research director.

The firm became cautious and took some profits after seeing interest rates "backing up but the stock market rising." The firm now thinks the Dow is in a trading range and "at best is fairly valued," said Mr. Stumpp. ■

Skills

Continued from page 2

from the management of external assets could help offset outlays the parent pays for handling pension fund investment management.

Executives at both Imperial Chemical and Electricity Supply tout their funds' performance and the fact they include property in their approaches. ICI's Mr. Allen also said managing some of ICI subsidiaries' funds of different sizes and liability requirements has given the investment management unit experience with suiting investment programs to clients' needs.

"We're trying to tailor our service and strategy . . . so that we come up with a suitable fund program rather then saying, 'It's our house's view that you should have, say 55% in U.K. equities, so much in bonds, etc.,' " he said.

Separately, the London-based Electricity Supply fund also will be restructuring its pension investment operations for its electric company clients. The decision results from regulations linked to last year's privatization of the electric industry.

Privatization resulted in the creation of 17 individual companies in England and Wales. According to Inland Revenue regulations, the assets of the now separate companies cannot be used to subsidize each other.

The Electricity Supply fund will comply with the regulation by introducing in April 1992 a unit trust investment arrangement, said Michael B. Cannan, the Electricity Supply fund's chief executive. The 17 companies' funds will be allotted a certain number of units, according to the size of their actuarial liabilities, that will be invested among five unit trusts — one each for U.K. equities, fixed income and property and two for overseas stock.

These new unit trusts will only be used for the electric companies' assets. While outside clients will be offered balanced management of stocks, bonds and real estate, their assets will be managed separately, Mr. Cannan said.

Electricity Supply has good reason for wanting the business: As part of the privatization agreements, the newly created companies will be free to drop Electricity Supply as their pension fund investment manager as of 1995.

Mr. Cannan said external clients are likely to choose the management firm because of its performance and for the opportunity to invest in real estate — which he said few other balanced fund managers now offer. "If the (management) capability can be found, then property is a very good form of investment for pension funds," he said. "While there may be volatility in the capital values of property, there is little income volatility from it.

"I feel there is interest in property among smaller to medium-size funds. Since property returns tend to be countercyclical to equities, a reasonable amount invested in property is necessary if you want a balanced return."

Mr. Cannan believes the Electricity Supply fund's overall returns also will prove alluring. "In equities, we were in the top one-third percentile for three out of the five years between 1985 and 1989," in the universe of the WM Co., Edinburgh. "In the other two years, our returns were at the median" of the WM universe, he said.

In property, "on a cumulative basis, we have been at the top 10% in any period since 1981," he said.

Electricity Supply reported that in calendar year 1989, it posted a 31.8% total return compared with a weighted average of 30.3% for the overall U.K. pension industry as measured by The WM Co.

Mr. Allen said ICI has ranked in the top quartile for the one-, five-, and 10-year periods ended in 1988, as measured by the Combined Actuarial Performance Service Ltd. and The WM Co. ■